Session Four:

Tax Code Complexity and Compliance Burden

2010 IRS Research Conference

Individual Taxpayer Compliance Burden: The Role of Assisted Methods in Taxpayer Response to Increasing Complexity

George Contos, Office of Research
John Guyton, Office of Research
Patrick Langetieg, Office of Research
Melissa Vigil, Office of Research

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Presentation Objectives

- Present compliance burden estimates for tax years 2000 to 2007

- Changes in compliance burden over time focusing on:
  - Tax system complexity
  - Assisted preparation methods
  - Technological improvements

Compliance Burden Research Program

Office of Research effort to measure and model compliance burden

- Individual Taxpayers
  - Studies for TY 1999 and TY 2000
  - Updated for TY 2007
  - New study planned for TY 2010

- Business Taxpayers
  - Studies covered small business taxpayers for TY 2003 and TY 2004
  - New study underway to cover all businesses for TY 2009
  - Integrated modeling framework with individual taxpayers

- Tax Exempt Taxpayers
  - Study planned for TY 2010

Burden Research Program Objectives

- Annual estimates provided to:
  - Taxpayers on tax forms
  - OMB for the Information Collection Budget to Congress

- Gain insight into determinants of compliance burden
  - Changes in the macro-economy, tax law, tax administration
  - Support policymaking and tax administration through "what-if" analysis

- Better understand the role of compliance burden in tax administration
  - Compliance costs impede compliance
  - Implications for demand for services

Compliance Burden Research Methodology

- Surveys measure time and out-of-pocket costs taxpayers spend on pre-filing and filing activities

- Control for substitution of time and money by *monetizing* time and reporting *total* compliance burden

- Establish econometric relationships between total compliance burden and tax return characteristics

- Use econometric micro-simulation model for forecasting and what-if analysis

Individual Burden Model Econometrics

- Dependent variable: Natural logarithm of total monetized compliance burden

- Includes controls for:
  - Income
  - Preparation method
  - Demographic characteristics

- Complexity as a function of the type and volume of activities performed
  - Proxy for type of activities: Complexity categories
  - Proxy for volume: Money amounts reported on tax form lines

Changes in Compliance Burden Drivers from Tax Years 2000 to 2007

- Increased use of assisted methods
  - Paid practitioner and software

- Increased tax system complexity
  - About 30 percent increase in tax code subsections and cross references
  - About 8 percent of taxpayers move from low complexity to higher complexity categories

- Technological changes, improved labor productivity
  - 15 to 20 percent increase

Tax Years 2000 to 2008 1040-Series Returns: Percentage of Tax Returns Prepared with Assistance

Tax Year	Third Party Prep Paid Preparer	Self Prepared with Software Assistance (On-Line Filed/Self V-Coded/Telefiled)	Taxpayers Using a Paid Preparer or Software Assistance or TCE & VITA
2000	55%	17%	72%
2001	57%	19%	76%
2002	57%	20%	79%
2003	61%	22%	84%
2004	59%	25%	85%
2005	59%	25%	86%
2006	60%	26%	87%
2007	56%	26%	85%
2008	60%	29%	92%

Source: R:S-97 Report, IRS Master File System, Compliance Data Warehouse, ETA, SOI

Tabulations: IRS:RAS:R:FDA, April 2010

Notes:

TY 2000 - 2004 software filings include telefiled returns.

TY 2006 data includes Forms 1040/A/EZ returns filed only to claim Telephone Excise Tax Refund.

TY 2007 data includes an estimated 15 million taxpayers that filed solely to claim an Economic Stimulus Payment.

Individual Burden Model Econometric Specification

$$Log(Burden)_i = b_0 + b_1 Log(mpi)_i + b_2 Low_i + b_3 Medium\_Low_i + b_4 Medium_i +$$

$$b_5 High_i + b_6 Paid_i + b_7 Soft_i + b_8 Paid\_mpi_i + b_9 Consider_i + b_{10} HH/Widow_i +$$

$$b_{11} Married_i + b_{12} Log(Exemptions_i) + \varepsilon_i$$

where the letter i indexes the taxpayer.

Individual Compliance Burden Coefficients
Tax Years 2000 and 2007

| Variable	Survey 2000 Coefficients		Survey 2007 Coefficients	
	Estimate	T-Stat	Estimate	T-Stat
	1	2	3	4
Intercept	0.247	1.53	1.163	**4.91**
Log (mpi)	0.491	**35.62**	0.439	**26.01**
Low Complexity	0.009	**11.59**	0.005	**5.69**
Low-Medium Complexity	0.009	**14.15**	0.008	**8.97**
Medium Complexity	0.012	**18.86**	0.013	**13.63**
High Complexity	0.023	**22.46**	0.014	**10.39**
Paid Professional Prepared Return	1.843	**9.87**	1.299	**4.74**
Self Prepared Return Using Software	-0.558	**-8.39**	-1.025	**-7.23**
Log (mpi) and Paid Professional Prepared Return	-0.224	**-14.84**	-0.178	**-9.15**
Consider Factor	-1.556	**-17.91**	-1.697	**-9.26**
Head of Household or Widow	-0.047	-1.48	-0.013	-0.29
Married	-0.270	**-8.68**	-0.306	**-6.57**
Log (Exemptions)	0.142	**5.41**	0.186	**5.03**
Adj. R-Squared	0.603		0.574	

Time and Money Burden Estimates using Blended 2000 and 2007 Coefficients
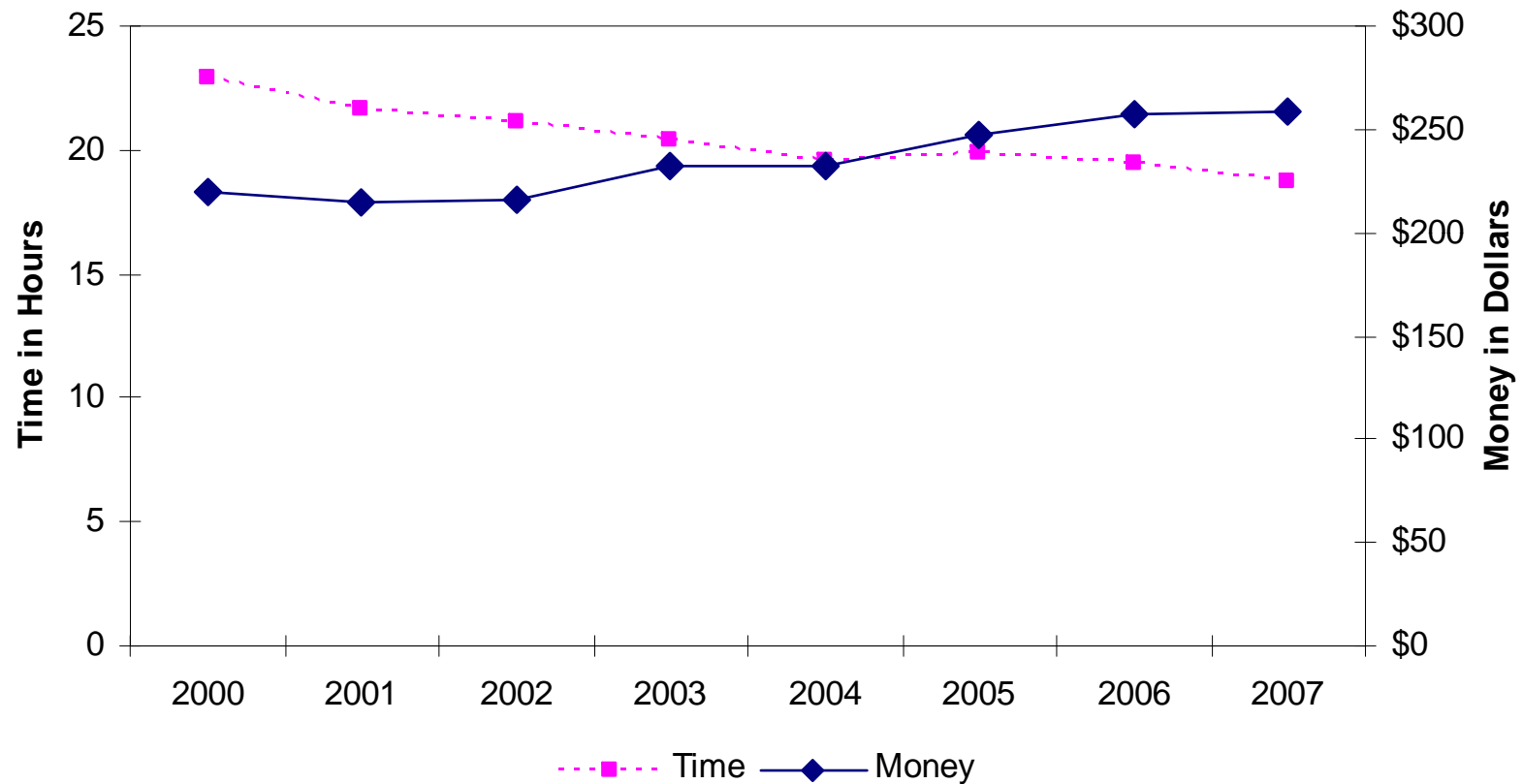
2007 constant dollars. TY 2007 excludes economic stimulus only returns.

Average Monetized Compliance Burden using Blended 2000 and 2007 Coefficients
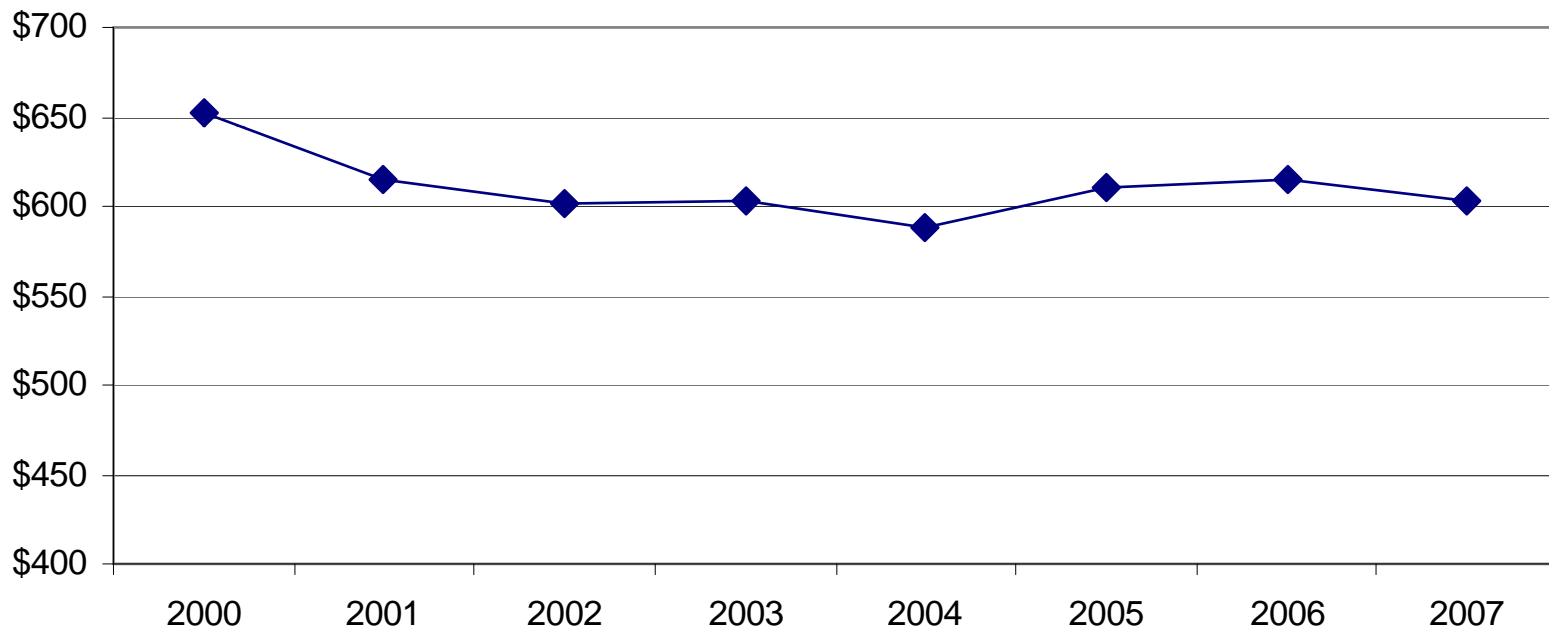
2007 constant dollars. TY 2007 excludes economic stimulus only returns.

Conclusions

- Despite increases in federal tax system complexity, we estimate that average constant dollar compliance costs did not increase from 2000 to 2007 and may have decreased

- The leading explanations are increased use of technology-assisted compliance methods, increased productivity, and interactions between the two

- It appears that technology is mitigating the compliance cost impact of an increasingly complex tax system – at least for now